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SIPDIS

SENSITIVE

TREASURY FOR INTERNATIONAL AFFAIRS - ASHAH AND CPLANTIER
NSC FOR BRYZA AND MCKIBBEN

E.O. 12958: N/A

TAGS: [EFIN](#) [TU](#)

SUBJECT: IMF RESREP MORE HOPEFUL ABOUT STANDBY AGREEMENT

REF: A. ANKARA 1075

[1](#)B. ANKARA 944

[1](#)C. ANKARA 812

[1](#)1. (SBU) Summary: IMF Resrep confirmed that the GOT has decided to water down its proposal to expand the investment incentives law, thereby opening the way to resolving the current standoff with the IMF. Provided the GOT: a) follows through on revising the investment incentives law so that it costs less; b) comes up with acceptable quality offsetting measures; and c) completes the outstanding prior actions, the Resrep believes there could be a board vote on the new standby in April. End Summary.

GOT Watering Down Investment Incentives:

[1](#)2. (SBU) In a February 24 meeting with Econ officers just following the Ambassador's separate meeting with Minister Babacan (ref A), the IMF Resrep largely confirmed Babacan's version of the state of play with the IMF, albeit with a less positive spin. If the GOT follows through on its stated willingness to narrow the scope of application of the amendment to the investment incentives law, and is able to head off parliamentary attempts to keep the scope as broad as possible, the Fund could accept good quality compensatory measures. The narrowed expansion of the investment incentives would only cost 0.1% of GNP according to the Resrep, though press reports put the figure at YTL 1 billion or closer to 0.3% of GNP.

Thanks to IMF Going Public:

[1](#)3. (SBU) The GOT willingness to backpedal on the investment incentives, however, has led Fund staff to feel vindicated about its decision to "go public" with its criticism of the scheme. However much this irritated the GOT, the IMF rep thinks it was worth it in order to demonstrate that it was a serious issue on which the Fund would not back down. The Resrep said that were the proposed expansion to stand as originally submitted to parliament, it would have been too costly for the Fund to accept compensatory measures that would meet acceptable quality standards and would have scuttled the program as agreed in December.

[1](#)4. (SBU) Nor does the Resrep believe that the GOT retreat demonstrates the existence of an ironclad GOT consensus on the need for the IMF. Though he believes that the isolationist view--i.e. that Turkey could go it alone without the IMF, as described to us by Governor Serdengecti in ref B--has now been knocked down, it certainly reared its ugly head over the past two months. As for Babacan's assertion that Krueger and Erdogan reached an understanding at Davos on the investment incentives, the Resrep believes the Turkish side misinterpreted Krueger, and in any case this does not explain why the GOT surprised the IMF with the investment incentives after publicly announcing agreement on a framework December 14. IMF staff suspect that Turkish Treasury staff were working on the investment incentives expansion prior to December 14.

Still Need Prior Actions:

[1](#)5. (SBU) The Resrep confirmed that, aside from the investment incentives issue, completion of the three prior actions in a form satisfactory to the IMF is not yet completely assured. The Banking Law seems to be about to go to the Council of Ministers in an IMF-compliant form and the internal Ministry of Finance turf fight about the Tax Administration Reform

Law that requires Prime Ministerial arbitration is not viewed as a critical issue by the IMF (the issue is whether the tax inspectors should be integrated into the Tax Administration rather than remain a separate board). Finance Minister Unakitan, himself a former tax inspector, is opposed to this integration, whereas Prime Ministry Undersecretary Dincer and Deputy Prime Minister Sener are reportedly in favor.

16. (SBU) However, the GOT has yet to decide by which measures the Social Security Reform will achieve the intended cost savings. Though the GOT committed to the IMF and World Bank that it would tweak the pension system rules in such a way as to achieve specific medium- and long-term cost savings, the devil is in the details. According to the Resrep, the Prime Minister has drawn red lines around some parameters he will not touch, thereby making it harder to find the necessary savings from other parameters. (Though the Resrep did not specify the parameters, they include: indexation of benefits, valuation of contributions, retirement age, replacement ratio, and years of service required to qualify for benefits).

Staving Off Other Bad Ideas:

17. (SBU) Aside from the investment incentives and the three prior actions, the Resrep said the IMF also has to keep an eye out for some bad ideas that continue to crop up. One of these is the idea of a VAT rate cut for the textile sector, an idea Fund Staff thought they had successfully killed in the fall. (Since the meeting with Resrep, press reports suggest this idea is very much alive.) Another bad idea is a proposal to have the state pick up the cost of businesses' severance payments when employees are laid off.

No Hard Financing Constraint:

18. (SBU) Despite a large repayment to the IMF due in May, the Resrep believes that Turkish Treasury could make these payments even if the IMF has not yet disbursed its first tranche beforehand. With Eurobond issuances well ahead of Treasury's planned external borrowing plan, and continued strong demand for domestic issuances, the Resrep does not believe the May payment is a hard constraint.

Timing of Next Steps:

19. (SBU) The Resrep said that a full mission will need to return to Turkey, given the time elapsed since the draft LOI had been drawn up. The mission is unlikely to engage in much negotiating: it will mostly confine itself to updating numbers and revising dates. The mission will not come, however, until the prior actions are taken. He thought that a board meeting in early April was possible, provided the GOT moved relatively quickly to resolve the outstanding issues.

EDELMAN